



STATE OF WASHINGTON

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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November 17, 2006

Honorable Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington D.C. 20554

Re: CC Docket No. 80-286 Reply Comments of the
Washington Utilities and Transportation Commission on
Jurisdictional Separations and Referral to the Federal-State Joint Board

Dear Secretary Dortch:

Enclosed please find an original and four copies of the Reply Comments of the Washington Utilities and Transportation Commission on Jurisdictional Separations and Referral to the Federal-State Joint Board, for filing with the Federal Communications Commission.

Should you have any questions concerning this document, please contact Lisa Steel at (360) 664-1303.

Sincerely,

CAROLE J. WASHBURN, Secretary



Although some efforts are under way to change the WUTC's role in traditional rate-of-return regulation for certain carriers, at this time Washington State retains its role in rate-of-return regulation and has the requisite experience to continue to perform this function well for carriers and services under its jurisdiction. As long as the current statutory and administrative framework remains in place, the WUTC believes that the FCC has a duty to resolve the longstanding and complex issue of separations. In its 2001 Separations Freeze Order, the FCC imposed an "interim" freeze of the Part 36 category relationships and jurisdictional cost allocation factors.³ The FCC ordered the freeze to last five years, until June 30, 2006, "or until the FCC has completed comprehensive reform of the Part 36 separations rules, whichever comes first."⁴ Because there has been no comprehensive reform of Part 36 rules since 2001, the freeze was set to end on June 30, 2006. However, in May 2006, the FCC extended the freeze for an "interim" period of three more years, or until the FCC completes comprehensive reform, whichever comes first.⁵ As discussed below, the 2001 Separations Freeze Order has created a large mismatch between revenues and costs for certain services, led to uncertainty in intrastate ratemaking, and provided opportunities for double recovery and potential anti-competitive behavior by telecommunications companies.

³ *Report and Order* (2001 Separations Freeze Order), CC Docket No. 80-286, 16 FCC Record 11382 (May 22, 2001). "Part 36" refers to the FCC's rules, at 47 CFR Part 36, that govern the way telephone companies apportion their accounting costs between the interstate and intrastate jurisdictions.

⁴ *Id.* at 11387-88.

⁵ The WUTC agrees with the comments asserting that the FCC took this action without proper public notice or comment or referral to the Federal-State Joint Board on Jurisdictional Separations. See *Comments of the Pennsylvania Public Utility Commission*, CC Docket No. 80-286 (August 21, 2006) at 1-2.

Mismatches between revenues and costs.

A fundamental principle of accounting is that revenues should be matched with the costs giving rise to those revenues.⁶ This principle goes to the heart of what makes accounting valid and useful. The FCC's Separations Freeze Order violates these fundamental principles. For some services, such as Digital Subscriber Line (DSL) services and special access lines, the effect of the accounting freeze has been to allocate most revenues from these services to the interstate jurisdiction but most of the costs to the intrastate jurisdiction.

This phenomenon was documented in a recent general rate case before the WUTC.⁷ The WUTC staff testimony in that case exposed the serious mismatch of revenues and costs among the interstate and intrastate jurisdictions associated with DSL and special access lines. The separations issues represented a key difference between the parties in that case, with Verizon arguing that intrastate rates should be bound by the FCC's rules for separations⁸ and with WUTC staff arguing from state statutes⁹ that only plant that is "used and useful for service" in Washington State should be reflected in intrastate rates, together with an appropriate level of revenues.¹⁰ While that case was eventually settled, the larger issue of separations remains

unresolved.

⁶ See, for example <http://www.maaw.info/Chapter1.htm>, "The Matching Concept and Cost Accounting – Matching."

⁷ *Wash. Utilities & Transp. Comm'n v. Verizon Northwest Inc.*, WUTC Docket UT-040788. Verizon Northwest is an incumbent local exchange telecommunications company that offers intrastate telecommunications services in Washington State. It is a wholly owned subsidiary of Verizon Inc.

⁸ Verizon Northwest claimed a need for a \$239.5 million increase in its general revenue requirement. WUTC Staff recommended a revenue decrease of \$26.0 million. That rate case, together with a depreciation case in which Verizon had requested an approximately \$50 million increase in revenues due to changes in its depreciation schedules (WUTC Docket UT-040520), was eventually settled for \$38.65 million in rate increases by July 1, 2007.

⁹ Wash. Rev. Code § 80.04.250.

¹⁰ WUTC Docket UT-040788, Redacted Revised Testimony of Paula M. Strain, Telecommunications Expert. A complete copy of the redacted testimony is available at <http://www.wutc.wa.gov/docket> UT-061708.

Regulatory uncertainty.

The FCC's continued separations freeze has also contributed to regulatory uncertainty in Washington State because it has prolonged the debate about whether the FCC's separations rules fairly allocate costs and revenues for intrastate ratemaking purposes, and delayed resolution of the issue. The uncertainties generated by this dispute, plus the potential for subsequent litigation, inform the investment decisions of incumbent local exchange carriers (LECs) in Washington State that may wish to file rate cases in the near future. The FCC should be concerned that the uncertainties of the continued freeze may delay investment in telecommunications infrastructure and services and potentially reduce the quality of services available to Washington consumers.

For all practical purposes, rates in the interstate jurisdiction are not regulated on a cost of service basis. By contrast, in Washington State, rates in the intrastate jurisdiction are so regulated.¹¹ Under these conditions, a proper jurisdictional allocation method is particularly important. The allocation of interstate costs to the intrastate jurisdiction, unmatched by an appropriate share of the revenues, provides incumbent LECs with the opportunity to recover the same costs in two jurisdictions, contrary to the FCC's stated goal for accounting separations.

This misallocation also has potential anticompetitive consequences in that it provides an opportunity to an incumbent LEC to leverage its regulated intrastate

¹¹ The FCC's jurisdiction extends to interstate and foreign telecommunications (see, e.g., 47 U.S.C. § 201(a)), and the states have jurisdiction over intrastate telecommunications in most cases. Washington state law authorizes companies to petition for alternative forms of regulation, Wash. Rev. Code § 80.36.135, and Qwest Corporation recently filed a petition for such regulation. Docket UT-061625. However, the WUTC continues to regulate most intrastate telecommunications services of incumbent LECs on a traditional rate base/rate of return basis.

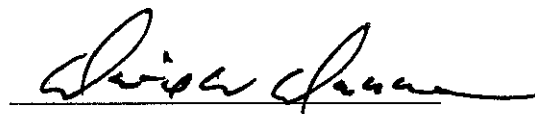
business to gain a greater advantage in its more-lightly regulated interstate or unregulated businesses.

The WUTC believes that the FCC should give particular consideration to the option contained in the first Glide Path Paper to assign rate regulation to those states that retain rate-of-return regulation, thereby eliminating the need for federal-state separations.¹² At this time, Washington State continues to be involved in rate regulation and has the requisite, recent experience to continue to perform this function in a timely and efficient manner. Assigning rate setting to the states results in lower regulatory costs, provides a single point of contact for pricing within in a state, and allows states to take into account the specific circumstances within their jurisdictions and implement policies that reflect those circumstances.

¹² *Options for Separations: A Paper Prepared by the State Members of the Separations Joint Board* (Glide Path Paper) (Dec. 17, 2001), at 22-23. This document is contained in the FNPRM as Appendix A.

In the end, the FCC should promptly address the adverse impacts of the separations freeze. Maintaining the status quo is not the answer, as that will only perpetuate problems and prevent solutions, harming ratepayers in the process.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "David W. Danner", is written over a horizontal line.

David W. Danner
Executive Director

Lisa Steel
Telecommunications Policy Advisor

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